

IN THE COURT OF APPEALS OF TENNESSEE
AT KNOXVILLE
August 15, 2007 Session

**STEVEN WATERS, ET AL. v. LOREN L. CHUMLEY, COMMISSIONER
OF REVENUE FOR THE STATE OF TENNESSEE**

**Appeal from the Chancery Court for Loudon County
No. 10710 Frank V. Williams III, Chancellor**

No. E2006-02225-COA-R3-CV - FILED SEPTEMBER 6, 2007

The issue we address in this appeal is whether Tennessee's Drug Tax is constitutionally valid. Plaintiff was arrested for possession of cocaine, and shortly thereafter, the Tennessee Department of Revenue assessed taxes, penalty, and interest against him pursuant to a state excise tax statute that levies a tax on persons in possession of designated amounts of unauthorized substances, T.C.A. § 67-4-2801, *et seq.* Subsequently, the Department of Revenue filed a tax lien against plaintiff's real property and executed a levy against his bank account. Plaintiff filed suit against the Commissioner of Revenue, charging that the tax statute violates both the state and federal constitutions. The trial court entered judgment in favor of plaintiff, decreeing that the tax constitutes a violation of constitutional rights of due process and protections against self incrimination. We affirm the trial court's conclusion upon the alternate ground that the statute is arbitrary, capricious, and unreasonable and, therefore, invalid under the Tennessee Constitution, in that it seeks to tax as a privilege, activity that prior legislation has designated as criminal activity.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed

SHARON G. LEE, J., delivered the opinion of the court, in which HERSCHEL P. FRANKS, P.J., and CHARLES D. SUSANO, JR., J., joined.

Robert E. Cooper, Attorney General and Reporter; Michael E. Moore, Solicitor General; and Brad H. Buchanan, Assistant Attorney General, Nashville, Tennessee, for the appellant, Loren L. Chumley, Commissioner of Revenue for the State of Tennessee.

A. Phillip Lomonaco, Knoxville, Tennessee, for the appellee, Steven Waters.

OPINION

I. Background

On April 25, 2005, the appellant, Steven Waters, was arrested by the Knoxville Sheriff's Department moments after purchasing approximately one thousand grams of cocaine from a confidential informant at a price of \$12,000. A few days later, the Tennessee Department of Revenue ("the Department") mailed Mr. Waters a notice of assessment dated May 6, 2005, which stated that it was a final demand for immediate payment of \$55,316.84, consisting of taxes in the amount of \$49,940; penalty in the amount of \$4,994; and interest in the amount of \$382.84. The notice of assessment further indicated that Mr. Waters was liable for such sum pursuant to T.C.A. § 67-4-2801, *et seq.* (hereinafter "the Drug Tax"), an excise tax on cocaine and other specified unauthorized substances possessed by a "dealer," which the statute implicitly defines to include a person who actually or constructively possesses seven or more grams of cocaine. The next day, the Department filed a notice of tax lien against real property owned by Mr. Waters in Lenoir City, Tennessee, and on or around July 8, 2005, the Department executed a tax levy against his bank account from which it confiscated approximately \$4,000.

On July 12, 2005, Mr. Waters and his wife, Naomi Waters¹, filed a complaint against the Department for declaratory judgment and injunctive relief. *Inter alia*, the complaint requested that the tax liens upon Mr. Waters' real property and bank account be set aside, that the Department be ordered to return the funds confiscated from Mr. Waters' bank account, and that the Drug Tax be declared unconstitutional upon grounds that its enforcement violates both state and federal constitutional protections against double jeopardy, self incrimination, and deprivation of property without due process. Following a nonjury trial of the case, the trial court concluded that enforcement of the Drug Tax violated state and federal constitutional guarantees of due process and protections against self incrimination, and entered judgment in favor of Mr. Waters. The Department appeals.

II. Issue

The sole issue we address in this appeal is whether the Drug Tax is a valid law under the Tennessee Constitution.

III. Analysis

The facts in this case are apparently not disputed, and we review the trial court's conclusions of law only. A trial court's conclusions of law are reviewed *de novo* and are accorded no presumption of correctness. *Campbell v. Florida Steel Corp.*, 919 S.W.2d 26, 35 (Tenn. 1996); *Presley v. Bennett*, 860 S.W.2d 857, 859 (Tenn. 1993).

The trial court determined that the Drug Tax was unenforceable because it violated rights against self incrimination guaranteed under the Fifth Amendment of the United States Constitution and under Article I, Section 9 of the Tennessee Constitution and due process rights guaranteed under

¹Naomi Waters was subsequently dismissed as a plaintiff and does not join in this appeal.

the Fourteenth Amendment of the United States Constitution and Article I, Section 8 of the Tennessee Constitution. While we also conclude the Drug Tax is constitutionally invalid, we reach that conclusion upon different grounds. **Benson v. United States Steel Corp.**, 465 S.W.2d 124, 130 (Tenn. 1971) (“If the trial court reached the correct result, the judgment below is entitled to affirmance, irrespective of the reason stated.”); *see also City of Brentwood v. Metro. Bd. of Zoning Appeals*, 149 S.W.3d 49, 60 (Tenn. Ct. App. 2004).

As stated, the Drug Tax is represented to be an excise tax, identified by the Legislature as such throughout the statute. *See generally* T.C.A. § 67-4-2801, *et seq.* (See Appendix for full recitation of the Drug Tax.) While the Tennessee Constitution does not specifically provide for legislative imposition of an “excise” tax, it does provide that “[t]he Legislature shall have power to tax merchants, peddlers, and *privileges*, in such manner as they may from time to time direct.” Tennessee Constitution Article II, Section 28 (emphasis added). Case law recognizes no distinction between a privilege tax and an excise tax. *See Bank of Commerce & Trust Co. v. Senter*, 260 S.W. 144, 148 (Tenn. 1924) (“Whether the tax be characterized in the statute as a privilege tax or an excise tax is but a choice of synonymous words, for an excise tax is an indirect or privilege tax.”); *American Airways, Inc. v. Wallace*, 57 F.2d 877, 880 (M.D. Tenn. 1937) (“The terms ‘excise’ tax and ‘privilege’ tax are synonymous and the two are often used interchangeably.”); *see also* 71 AM JUR. 2d State and Local Taxation §24, (“The term ‘excise tax’ is synonymous with ‘privilege tax,’ and the two have been used interchangeably. Whether a tax is characterized in the statute imposing it as a privilege tax or an excise tax is merely a choice of synonymous words, for an excise tax is a privilege tax.”) Thus, the excise tax now before us is, by more complete description, purportedly an excise upon a particular privilege, assessed according to the quantity of substance possessed in enjoyment of such privilege.

It has long been recognized in this state that “[t]he right to tax is essential to the existence of government, and is peculiarly a matter for the Legislature, and the legislative power in this respect can only be restrained by a distinct and positive expression in the fundamental law.” **Vertrees v. State Bd. of Elections**, 214 S.W. 737, 740 (Tenn. 1919). It is also well settled that the Legislature’s power to tax privileges is extremely broad, and in an early case, the Tennessee Supreme Court declared that “a privilege is whatever the legislature choose to declare a privilege, and to tax as such.” **Kurth v. State**, 5 S.W. 593, 594 (Tenn. 1887). While this statement might appear to indicate that the Legislature’s right to tax in this regard is unlimited, later language of the Court reveals that this is not so. In **Hooten v. Carson**, 209 S.W.2d 273, 274 (Tenn. 1948), the high Court acknowledged the extent of the Legislature’s power to impose a privilege tax, stating that “the power to tax privileges is not subject to any constitutional limitation except that *the tax levied must not be arbitrary, capricious or wholly unreasonable.*” (Emphasis added). It is our determination that the Drug Tax exceeds this limitation.

The Drug Tax levies a tax on unauthorized substances and specifically provides that the tax “does not apply to a substance in the possession of a dealer who is authorized by law to possess the substance.” T.C.A. § 67-4-2804(a). Furthermore, the tax applies only to persons in unauthorized possession of substances which the Legislature has declared to be illegal, either, in the case of controlled substances such as marijuana and cocaine, pursuant to its enactment of the Tennessee Drug Control Act, codified at T.C.A. § 39-17-401, *et seq.*, or, in the case of certain alcoholic

beverages, because not authorized by the alcoholic beverage commission. However, contrary to prior enactments pronouncing the substances at issue illegal, the Legislature, through the Drug Tax, now seeks to tax the possession of these substances upon the premise that the possession of such is a privilege. “It cannot be denied that the Legislature can name any privilege a taxable privilege and tax it by means other than an income tax, but the Legislature cannot name something to be a taxable privilege unless it is first a privilege.” *Jack Cole Co. v. MacFarland*, 337 S.W.2d 453, 455 (Tenn. 1960). Because it seeks to levy a tax on the privilege to engage in an activity that the Legislature has previously declared to be a crime, not a privilege, we must necessarily conclude that the Drug Tax is arbitrary, capricious, and unreasonable, and therefore, invalid under the Constitution of this state.

Our conclusion in this regard is further consistent with the rationale supporting the imposition of a privilege tax, which holds that such a tax recompenses the state for the secure and nurturing environment it has provided the activity or occupation upon which the tax is levied. As our Supreme Court has acknowledged:

Taxation of the privilege is upon the occupation or activity carried on amid the social, economic, and industrial environment, under protection of the state. Without the opportunity and protection afforded by the state, none of those classed and taxed as privileges could exist; every element that enters into the composition of a civilized state supplies them sustenance and strength

Excising the result of an occupation or activity in the modern state may be likened to the ancient custom of huntsmen sharing with the dispensing gods of bounty a small portion of the captured game.

Senter, 260 S.W. at 146 (internal citations omitted). Obviously, the state offers those in possession of illegal substances no protection or sustenance, and its role with respect to such persons can hardly be described as that of a “dispensing god of bounty.” On the contrary, the state’s proper role is to deter those in possession of unauthorized substances, and consistent with this posture, part of the stated purpose of the Drug Act is “to levy an excise tax to generate revenue for state and local law enforcement agencies for use by those agencies to investigate, combat, prevent and reduce drug crimes.” T.C.A. § 67-4-2801. The Legislature’s enactment of the Drug Tax is not supported by the rationale justifying the enactment of a privilege tax.

IV. Conclusion

For the foregoing reasons, we affirm the judgment of the trial court. Costs of appeal are assessed to the appellant, Loren L. Chumley, Commissioner of Revenue for the State of Tennessee.

SHARON G. LEE, JUDGE

APPENDIX

§ 67-4-2801. Purpose.

The purpose of this part is to levy an excise tax to generate revenue for state and local law enforcement agencies for use by those agencies to investigate, combat, prevent and reduce drug crimes, and for the general fund. Nothing in this part may in any manner provide immunity from criminal prosecution for a person who possesses an illegal substance.

§ 67-4-2802. Definitions

As used in this part, unless the context clearly requires otherwise:

- (1) "Commissioner" means the commissioner of revenue;
- (2) "Controlled substance" means a controlled substance as defined in § 39-17-402, and not included in "low-street-value drugs";
- (3) "Dealer" means any of the following:
 - (A) A person who actually or constructively possesses more than forty-two and one-half (42.5) grams of marijuana, one (1) or more marijuana plants, seven (7) or more grams of any other unauthorized substance that is sold by weight, or ten (10) or more dosage units of any other unauthorized substance that is not sold by weight; or
 - (B) A person who in violation of title 57, chapter 3, part 2, possesses an illicit alcoholic beverage for sale;
- (4) "Illicit alcoholic beverage" means an alcoholic beverage, as defined in § 57-3-101, not authorized by the Tennessee alcoholic beverage commission. "Illicit alcoholic beverage" includes, but is not limited to, the products known as "bootleg liquor," "moonshine," "non-tax-paid liquor," and "white liquor;"
- (5) "Local law enforcement agency" means a municipal police department, a metropolitan police department, or a sheriff's office;
- (6) "Low-street-value drug" means any of the following controlled substances:
 - (A) An anabolic steroid as defined in § 39-17-410(f);
 - (B) A depressant described in § 39-17-412(c);
 - (C) A hallucinogenic substance described in § 39-17-406(d);
 - (D) A stimulant described in § 39-17-412(e); or
 - (E) A controlled substance described in § 39-17-414;
- (7) "Marijuana" means all parts of the plant of the genus cannabis, whether growing or not; the seeds of this plant; the resin extracted from any part of this plant; and every compound, salt, derivative, mixture, or preparation of this plant, its seeds, or its resin;
- (8) "Person" means person as defined in § 39-17-402;
- (9) "State law enforcement agency" means any state agency, force, department, or unit responsible for enforcing criminal laws; and
- (10) "Unauthorized substance" means a controlled substance, a low-street-value drug or an illicit alcoholic beverage.

§ 67-4-2803. Excise tax on unauthorized substances and illicit alcoholic beverages

(a) An excise tax is levied on unauthorized substances possessed, either actually or constructively, by dealers at the following rates:

- (1) Forty cents (40¢) for each gram, or fraction thereof, of harvested marijuana stems and stalks that have been separated from and are not mixed with any other parts of the marijuana plant;
- (2) Three dollars and fifty cents (\$3.50) for each gram, or fraction thereof, of marijuana, other than separated stems and stalks taxed under subdivision (a)(1) or plants with foliage taxed under (a)(3);
- (3) Three hundred fifty dollars (\$350) per plant, whether growing or detached from the soil, on each marijuana plant with foliage;

- (4) Fifty dollars (\$50.00) for each gram, or fraction thereof, of cocaine;
- (5) Two hundred dollars (\$200) for each gram, or fraction thereof, of any other controlled substance or low-street-value drug that is sold by weight;
- (6) Fifty dollars (\$50.00) for each ten (10) dosage units, or fraction thereof, of any low-street-value drug that is not sold by weight; or
- (7) Two hundred dollars (\$200) for each ten (10) dosage units, or fraction thereof, of any other controlled substance that is not sold by weight.
- (b) A quantity of marijuana or other unauthorized substance is measured by the weight of the substance whether pure, impure or dilute, or by the number of dosage units in the dealer's possession when the substance is not sold by weight. A quantity of an unauthorized substance is dilute if it consists of a detectable quantity of pure controlled substance and any excipients or fillers.
- (c) An excise tax is levied on illicit alcoholic beverages possessed by a dealer at the following rates:
 - (1) Thirty-one dollars and seventy cents (\$31.70) for each gallon, or fraction thereof, of illicit alcoholic beverages sold by the drink; or
 - (2) Twelve dollars and eighty cents (\$12.80) for each gallon, or fraction thereof, of illicit alcoholic beverages not sold by the drink.
- (d) For purposes of this part, a person constructively possesses an unauthorized substance when the person has knowledge of the substance and the ability and intention to exercise control over the substance.

§ 67-4-2804. Exemptions

- (a) The tax levied in this part does not apply to a substance in the possession of a dealer who is authorized by law to possess the substance. This exemption applies only during the time the dealer's possession of the substance is authorized by law.
- (b) The tax levied in this part does not apply to the following marijuana:
 - (1) Harvested mature marijuana stalks when separated from and not mixed with any other parts of the marijuana plant;
 - (2) Fiber or any other product of marijuana stalks described in subdivision (b)(1), except resin extracted from the stalks;
 - (3) Marijuana seeds that have been sterilized and are incapable of germination; or
 - (4) Roots of the marijuana plant.

§ 67-4-2805. Affixing of stamps; reports

- (a) The commissioner shall issue stamps to affix to unauthorized substances to indicate payment of the tax required by this part. Dealers shall report the taxes payable under this part at the time and on the form prescribed by the commissioner. Dealers are not required to give their name, address, social security number, or other identifying information on the form. Upon payment of the tax, the commissioner shall issue stamps in an amount equal to the amount of the tax paid. Taxes may be paid and stamps may be issued either by mail or in person.
- (b) Every local law enforcement agency and every state law enforcement agency must report to the department of revenue within forty-eight (48) hours after seizing an unauthorized substance, or making an arrest of an individual in possession of an unauthorized substance, listed in this subsection (b) upon which a stamp has not been affixed. The report must be in the manner prescribed by the commissioner and must include the time and place of the arrest or seizure, the amount, location, and kind of substance, the identification of any individual in possession of the substance and such individual's social security number, and any other information prescribed by the commissioner. The report must be made when the arrest or seizure involves any of the following unauthorized substances upon which a stamp has not been affixed as required by this part:
 - (1) More than forty-two and one-half (42.5) grams of marijuana;
 - (2) One (1) or more marijuana plants;
 - (3) Any illicit alcoholic beverage;

- (4) Seven (7) or more grams of any other unauthorized substance that is sold by weight; or
- (5) Ten (10) or more dosage units of any other unauthorized substance that is not sold by weight.

§ 67-4-2806. Payment of tax

The tax imposed by this part is payable by any dealer who actually or constructively possesses an unauthorized substance in this state upon which the tax has not been paid as evidenced by a stamp issued by the commissioner. The tax is payable within forty-eight (48) hours after the dealer acquires actual or constructive possession of a non-tax-paid unauthorized substance, exclusive of Saturdays, Sundays, and legal holidays of this state, in which case the tax is payable on the next working day. If the tax is not paid within forty-eight (48) hours, the tax will become delinquent and shall accrue penalty and interest pursuant to the provisions of chapter 1, part 8 of this title. Upon payment of the tax, the dealer shall permanently affix the appropriate stamps to the unauthorized substance. Once the tax due on an unauthorized substance has been paid, no additional tax is due under this part even though the unauthorized substance may be handled by other dealers. If a dealer is found in possession of a substance taxable under this part that does not have the appropriate tax stamp affixed, it shall be presumed the dealer has been in possession of such substance for longer than forty-eight (48) hours, exclusive of Saturdays, Sundays, and legal holidays of this state.

§ 67-4-2807. Assessment of tax, penalty, and interest

Notwithstanding any other provision of law, an assessment against a dealer who possesses an unauthorized substance to which a stamp has not been affixed as required by this part shall be made as provided in this section. The commissioner shall immediately assess tax, applicable penalty, and interest based on any information brought to the attention of the commissioner, or the commissioner's duly authorized assistants, that a person is liable for unpaid tax pursuant to this part. The tax shall be assessed in the same manner as any other tax assessment, except when the provisions of this part specify otherwise. The commissioner shall notify the dealer in writing of the amount of the tax, penalty, and interest due, and demand its immediate payment. The notice of assessment and demand for payment shall be either mailed to the dealer at the dealer's last known address or served on the dealer in person. If the dealer does not pay the tax, penalty, and interest immediately upon receipt of the notice and demand, the commissioner shall collect the assessment, including penalty and interest, pursuant to the procedure set forth in chapter 1, part 14 of this title, unless the dealer files with the commissioner sufficient security in the amount of the assessment, including penalty and interest. Unless security is provided, the assessment shall be deemed a jeopardy assessment, and the commissioner shall use all means available to collect the assessment from any property in which the dealer has a legal, equitable, or beneficial interest. The dealer may seek review of the assessment as provided in chapter 1, part 18 of this title, except to the extent those provisions are modified by this part. The provisions of § 67-1-1802 are applicable to the tax levied by this part, except that a claim for refund shall be filed within six (6) months of the date of payment of the tax. For purposes of this section, "sufficient security" shall mean one (1) of the forms of security listed in § 67-1-1801(c)(1)(A) through (c)(1)(C).

§ 67-4-2808. Confidential information; criminal penalties

Notwithstanding any other provision of law, information obtained pursuant to this part is confidential and, unless independently obtained, may not be used in a criminal prosecution other than a prosecution for a violation of this part. Stamps issued pursuant to this part may not be used in a criminal prosecution other than a prosecution for a violation of this part. The provisions of chapter 1, part 17 of this title, including the criminal penalties specified therein, shall apply to the tax levied under this part. This section does not prohibit the commissioner from publishing statistics that do not disclose the identity of dealers or the contents of particular returns or reports.

§ 67-4-2809. State unauthorized substances tax account; unencumbered tax proceeds

(a) The commissioner shall credit the proceeds of the tax levied by this part to a special nonreverting account, to be called the state unauthorized substances tax account, until the tax proceeds are unencumbered. The

commissioner shall remit the unencumbered tax proceeds as provided in this section on a quarterly or more frequent basis.

(b)(1) Tax proceeds are unencumbered when:

(A) The tax has been paid and the collection process completed; and

(B)(i) The taxpayer has no current right to file a refund claim, and the paid tax is not the subject of any pending lawsuit for the recovery of that tax; or

(ii) The time for the taxpayer to file suit pursuant to § 67-1-1802(c) has expired.

(2) The commissioner shall first apply the unencumbered tax proceeds to the costs of storing and disposing of the assets seized in payment of the assessment under this part, which costs shall be added to and become part of the assessment. From the remaining proceeds, the commissioner shall remit seventy-five percent (75%) of the unencumbered tax proceeds that were collected by assessment to the state or local law enforcement agency that conducted the investigation of a dealer that led to the assessment. Such proceeds are to be used by the agency solely for the purpose of investigating, combating, preventing, and reducing drug crimes. If more than one (1) state or local law enforcement agency conducted the investigation, the commissioner shall determine the equitable share for each agency based on the contribution each agency made to the investigation. The commissioner's determination of the equitable share for each agency shall be final, and shall not be subject to review in an administrative or judicial proceeding. The commissioner shall credit the remaining unencumbered tax proceeds to the general fund.

(c) Notwithstanding any other provision of this section, in the event the tax levied by this part is voluntarily paid to the department of revenue, and not as a result of an investigation or arrest by a state or local law enforcement agency, such voluntarily paid tax shall be considered unencumbered upon payment, and the commissioner shall credit the entire tax proceeds to the general fund.

§ 67-4-2810. Immunity from prosecution or conviction

The provisions of this part shall not be construed to confer any immunity from criminal prosecution or conviction for a violation of title 39, chapter 17, part 4, upon any person who voluntarily pays the tax imposed by this part or who otherwise complies with the provisions of this part.

§ 67-4-2811. Rules and regulations

The commissioner shall have the authority to promulgate rules in accordance with the Uniform Administrative Procedures Act, compiled in title 4, chapter 5, to implement, administer and enforce the provisions of this part.